Markets in a Minute

28 April 2020

Panic has passed, markets looking ahead to a recovery

"Often the biggest stimulus during an economic slowdown comes through a falling oil price. On that basis there would never have been such a meaningful stimulus than the price of WTI oil futures dropping to -$40. Unfortunately, this weakness reflects an inability to use rather than afford oil, so it will provide less of a tonic for global demand."

Guy Foster, Head of Research – Brewin Dolphin

The markets went sideways last week, despite a swathe of downbeat economic data, which means the panic is over and markets are looking for clues about the future. The Covid-19 curves are flattening or trending down, and numerous areas have set out loose plans for easing lockdowns, including New York which reported its lowest death rate in a month over the weekend. Several countries in Europe have set out schedules for reopening but the UK extended its lockdown for three weeks last week with no explanation about potential easing dates. Therefore, more difficult questions linger for investors, including:

- **When will the UK lockdown end?**
- **How will companies adapt to reopening and will consumer behaviour change?**
- **Will we have to lockdown again for a second wave?**
- **When will we get therapeutics or a vaccine?**
- **How strongly will the economy bounce back in the meantime?**

Until we have the answers, markets will likely be volatile, jumping on positive developments and falling on setbacks.

The right medicine

Around the world there are more than 100 coronavirus vaccine projects under way, and the first patients were recruited for human trials of a potential vaccine at Oxford University last week.

There were high hopes for Gilead's antiviral drug, Remdesivir, that helped push markets up two weeks ago. But after the FT reported that the drug had "flopped" based on a leaked draft of inconclusive test results last week, the company's shares fell sharply. We will have to wait for the results of more trials to draw a firm conclusion. Further trials continue on various drugs and treatments including chloroquine which should produce results within the next three months.

More stimulus on the way

The policy response to this crisis has been remarkably bullish and has helped sustain markets in the face of unprecedented headwinds. Indeed, the US market is only 15% below its all-time high despite US unemployment rising by 26m in just the past five weeks.

The latest measures include:

UK

The government has announced it will guarantee 100% of loans to small businesses in a bid to speed up the flow of cash to struggling companies. The existing business interruption scheme for small firms came under fire because of slow processing by banks, which often applied credit checks or insisted on security for the loans. Now, with a 100% taxpayer-funded guarantee, there is no risk that banks will not get their money back. This should expedite the application process and could save thousands of firms across the country.

US

Congress approved a further $320 bn for the Paycheck Protection Programme for small businesses after the first $350 bn ran out in record time.

China

China has announced further stimulus but in total it amounts to less than half the level it unleashed during the financial crisis, largely due to its ballooning debt-to-GDP ratio. It is also dealing with an unwelcome second wave which is requiring renewed lockdowns in some areas.

Eurozone

Two weeks ago, the EU announced a EUR 540 bn bailout package, consisting of numerous components such as:

- Credit lines to the European Stability Mechanism, which is the EU's bailout mechanism set up following the financial crisis.
- Boost in European investment bank lending capacity: The EU is creating a guarantee fund worth EUR 25 bn, which will support 200 bn in financing for small and mid-sized companies.

The European Council met again last Thursday and while nothing concrete was agreed, Angela Merkel announced that Germany is prepared to make a substantial financial contribution to an EU fund. The idea is for each EU country to increase its contribution to the seven-year budget. Leaders are still divided on whether the aid will take the form of grants or loans.

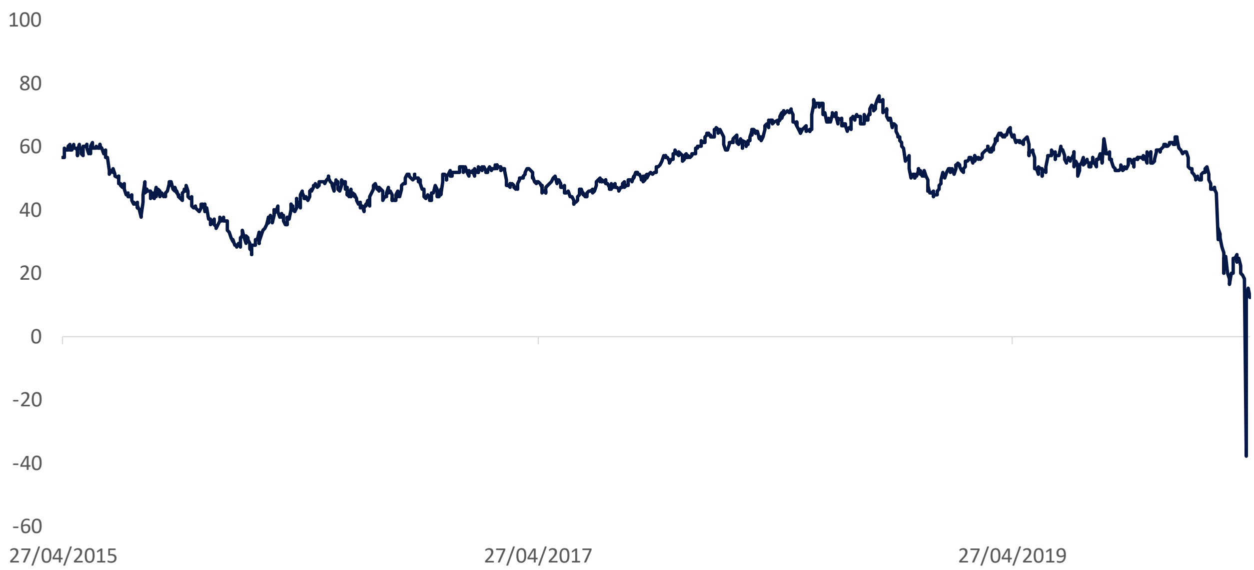
Some companies already rebounding

Last week we heard that housebuilders Taylor Wimpey and Persimmon were restarting site work and Berkley Group will reopen 80% of its sites this week. Shares have jumped accordingly. Housebuilders were never formally forbidden from operating – construction sites have always been allowed to stay open – but most building firms stopped work voluntarily until they could be sure appropriate social distancing practices were adopted.

The delayed inflationary effect of the oil chaos

The inflation figure came in at 1.5% for March, down from 1.7% in February, driven by the falling oil price (as seen in the graph below) and also slumping clothing costs. Typically, falling oil prices will suppress inflation which is already being pulled lower by the standstill in sales of non-food product prices due to the lockdown. The dynamics of the energy market mean low prices discourage future supply and the replacement of existing capacity, and they also create a base effect (a low level from which to calculate a year on year change in prices) raising the prospect of a jump in inflation in a year's time.

Oil price



Source: Datastream April 2020

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